

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

**Gregory Scott
Edward A. Garvey
Marshall Johnson
LeRoy Koppendrayer
Phyllis A. Reha**

**Chair
Commissioner
Commissioner
Commissioner
Commissioner**

**In the Matter of a School District Extended
Area Service Petition among the Exchanges
of Granger, Fountain, Cherry Grove,
Harmony, and Preston**

ISSUE DATE: June 6, 2001

DOCKET NO. P-401, 551, 407, 532/CP-99-12

ORDER REQUIRING FURTHER FILINGS

PROCEDURAL HISTORY

On January 7, 1999, telephone subscribers in the Granger, Fountain, Cherry Grove, Harmony, and Preston exchanges filed a petition for School District Extended Area Service (EAS) between these five exchanges. These exchanges make up Independent School District No. 2198.

The Granger exchange is served by Ace Telephone Association. The Fountain and Cherry Grove exchanges are served by Citizens Telecommunications of Minnesota. The Harmony exchange is served by Harmony Telephone Company. The Preston exchange is served by CenturyTel of Minnesota, Inc.

On July 19, 1999, the Commission issued its ORDER REQUIRING TRAFFIC STUDIES, COST STUDIES, AND PROPOSED RATES. Among other things, that Order found that the petition met threshold requirements of adjacency and school district residency. The Order required the incumbent local exchange carriers serving the five exchanges to determine the costs of installing and operating the proposed EAS route and to file proposed rate additives that would recover these costs. The Commission would then poll the exchanges' subscribers to determine whether they wanted EAS at those rates.

The companies duly filed their cost studies and proposed rate additives. On August 23, 2000, the Department of Commerce (the Department) filed comments on the companies' filings. In brief, the Department recommended the following action:

- 1. apportioning the facilities costs of the proposed EAS route equally among all affected customers, except to the extent necessary to preserve existing ratios between customer classes;**
- 2. excluding lost access revenues from the cost calculations and rate additives adopted in the case.**

Between October 3 and October 10, 2000, all four incumbent carriers filed comments

opposing the exclusion of lost access revenues from EAS rate additives.

On October 3, 2000, the Minnesota Independent Coalition (MIC), whose members include over 80 incumbent local exchange carriers throughout the state, intervened on behalf of its members. MIC, too, opposed the exclusion of lost access revenues from EAS rate additives.

On February 13, 2001, the Department filed supplementary comments. On March 23, 2001, the MIC filed supplementary comments.

On May 22, 2001, the matter came before the Commission. At that time the Residential Utilities Division of the Office of the Attorney General appeared on behalf of residential ratepayers.

FINDINGS AND CONCLUSIONS

I. Factual and Legal Background

Extended area service (EAS) is a service arrangement permitting neighboring telephone exchanges to become a single local calling area with toll-free calling. In non-school district cases, the criteria for installing EAS and the procedures for determining and allocating EAS costs are set forth in Commission Orders¹ issued after an industry-wide fact-finding and policy-making proceeding mandated by the Minnesota Legislature.²

In 1997, the Legislature established separate criteria and procedures for installing EAS between exchanges in the same school district.³ School District EAS petitions are subject to less stringent traffic requirements and broader public support requirements than conventional EAS petitions. Briefly, School District EAS criteria and procedures are as follows.

A. School District EAS Installation Criteria

- (1) A petition for School District EAS must be signed by at least 15% of the subscribers in each exchange, or 600 subscribers in each exchange, whichever is less;**
- (2) at least 10% of the subscribers in each exchange must be residents of the school district for which EAS is sought;**

¹ **In the Matter of an Investigation into the Appropriate Local Calling Scope, in Accordance with Minn. Stat. 237.161 (1994), Docket No. P-999/CI-94-296, ORDER REACTIVATING THE PROCESSING OF EAS PETITIONS (October 24, 1995), ORDER AFTER RECONSIDERATION (February 23, 1996).**

² Laws 1994, c. 534, art. 1, § 1.

³ Laws, 1997, c. 59, § 1, as amended by Laws 1998, c. 326, § 1, subd. 2.

- (3) each exchange must be contiguous to at least one of the other exchanges for which EAS is sought;
- (4) a majority of the subscribers in each exchange who return their EAS ballots must vote in favor of the proposed route.

B. School District EAS Costs and Rates

The School District EAS statute requires rates to be based on the costs set forth below:

For a proposal to install extended area service under this section, proposed rates must be based on specific additional cost incurred, operating expenses, actual cost for new facilities constructed specifically to provide for extended area service, net book value of existing facilities transferred from another service to extended area service, and appropriate contributions to common overheads.

Laws 1997, c. 59, subd. 5.

The statute also requires the Commission to use its ratemaking authority to hold local exchange carriers harmless at the same time that it sets EAS rates:

The commission shall establish rates that are income neutral for each affected telephone company at the time at which the commission determines the extended area service rates.

Laws 1997, c. 59, subd. 6.

Finally, the statute requires that all exchanges in a School District EAS route share the costs of the route equally:

*The costs of providing extended area service under this section must be apportioned equally among the exchanges identified in the petition. The costs must be apportioned among the customers in each exchange so that the relationship between the rates for classes of basic local service remains the same.
...*

Laws 1997, c. 59, subd. 6.

II. The Issues

A. Historical Background

Setting fair and reasonable rates for extended area service – School District or conventional – has long been a conundrum, mainly because converting a “premium” service (long distance) to a basic service (local service) disturbs the complex web of subsidies by which traditional rate-of-return regulation has promoted universal service. To keep local service rates as low as possible – and thereby promote universal service – this and other state commissions have permitted local exchange carriers to charge long distance carriers “access charges” that arguably exceed the actual costs of providing access to the local network.

When long distance routes become local service routes, companies lose these access revenues. To keep the companies whole, the Commission has traditionally built recovery of lost access charges into both conventional and School District EAS rate additives.

In recent cases the Department has challenged this practice, arguing that the access revenues lost when toll routes become EAS routes are not true costs of the EAS routes, but are hidden subsidies to company-wide costs. The Department has therefore urged the Commission to exclude lost access revenues from EAS rates and to instead require any necessary recovery of these costs to come from the general body of ratepayers.

B. The Parties' Positions

1. The Department of Commerce

The Department of Commerce argued that access revenues lost when toll routes become EAS routes should not be included in EAS rate additives for the following reasons:

- (1) Forcing customers in the EAS exchange to make up these lost subsidies forces them to bear more than their fair share of network costs.**
- (2) Including these lost subsidies in EAS rates undermines local competition, which the Commission has a statutory duty to nurture and promote,⁴ by guaranteeing perpetual revenue streams to incumbents.**
- (3) Since most companies now operate under alternative regulation, there is no longer a practical need or a philosophical justification to build lost access revenues into EAS rate additives – companies now have a host of other ways to recoup the access revenues they lose when EAS is installed.**

2. The Companies and the Minnesota Independent Coalition (MIC)

The Companies and the MIC argued that the Commission should include lost access revenues in the EAS rates set in this case for the following reasons:

- (1) The Department has not demonstrated that it is more fair to recover the lost access revenues from the general body of ratepayers than from the customers in these exchanges. In fact, company records suggest that shifting all responsibility for these lost revenues to the general body of ratepayers would result in the EAS ratepayers bearing less than their fair share of common costs, common overheads, and reasonable profits.**
- (2) It is unfair to raise the rates of customers who will not benefit from the new EAS route and who cannot vote on whether or not it is installed.**

⁴ Minn. Stat. §§ 237.011, 237.16.

- (3) The Alternative Form of Regulation (AFOR) statute⁵ under which two of the companies operate gives the companies, not the Commission, the right to determine which rates to adjust for EAS costs, and it explicitly permits the companies to choose to adjust their EAS rates.
- (4) As a matter of law and sound public policy, the decision to eliminate access charges from EAS rate additives should only be made in a rulemaking or other industry-wide, state-wide proceeding.

3. The Residential Utilities Division of the Office of the Attorney General (RUD-OAG)

The RUD-OAG urged the Commission to include the lost access revenues in these EAS rate additives for the following reasons:

- (1) It would be unfair and unsound as a matter of public policy to assign responsibility for these revenue losses to non-EAS customers, because those customers would not benefit from the service to which the losses relate and would have no vote on whether or not the service was installed;
- (2) There is no evidence in the record for the Department's claim that including lost access revenues in these rates would force EAS customers to subsidize other customers' rates; relieving these customers of all responsibility for these lost revenues could result in their bearing less than their fair share of common costs.

III. Commission Action

A. Lost Access Revenues Included in EAS Rates

The issue of whether to include lost access revenues in EAS rates is complex, and the Commission's perspective has been evolving over time. In the first two cases raising the issue, the Commission ordered the exclusion of lost access revenues.⁶ In the second two cases, the Commission ordered exclusion initially, but on reconsideration reversed both decisions and

⁵ Minn. Stat. § 237.773.

⁶ In the Matter of the Petition for Extended Area Service from Nicollet to Mankato, St. Peter, and Cambria, P-414, 416, 421/CP-97-44, ORDER ESTABLISHING RATES FOR POLLING (May 5, 2000); In the Matter of a Petition for Extended Area Service from the Almelund Exchange to the Metropolitan Calling Area, Docket No. P-407, 405, 413, 520, 426, 427, 430, 421/CP-97-1237, ORDER ESTABLISHING RATES FOR POLLING (July 25, 2000).

followed the traditional practice of including lost access revenues in EAS rates.⁷ In the next two cases, the Commission followed traditional practice, but at the same time required the companies to itemize the access revenue component of the EAS rates, so that it could be tracked – and eventually treated – as a subsidy.⁸

Here, too, the Commission will include lost access revenues in EAS rates instead of collecting them from the general body of ratepayers. Subsidies or not, access charges are a mainstay of Minnesota's local rate structure, including the EAS rate structure. They make indispensable contributions to common costs, common overheads, and reasonable profits. When access charges disappear, new sources of revenue must be found to replace them.

The Commission has opened two dockets for just that purpose – one to probe the cost basis of access charges⁹ and the other to develop a funding mechanism to replace the subsidy portion of access charges with a universal service stipend.¹⁰ These dockets hold great promise for reducing inequities between ratepayers and for speeding and strengthening competition.

In the mean time, however, the benefits of removing lost access revenues from EAS rate additives are not clear enough, certain enough, or significant enough to offset clear costs in fairness, administrative efficiency, and ratepayer confusion. This is especially true in the School District context, where the Legislature has required the Commission to ensure income neutrality at the same time that it sets EAS rates.

⁷ In the Matter of a Petition for Extended Area Service from the Osakis Exchange to the Alexandria Exchange, Docket No. P-552, 430/CP-98-1148, ORDER GRANTING RECONSIDERATION AND REQUIRING FURTHER FILINGS (April 20, 2001); In the Matter of a School District Extended Area Service Petition Among the Exchanges of Jeffers, Lamberton, Sanborn, and Storden, Docket No. P-551, 570/CP-97-1797, ORDER GRANTING RECONSIDERATION AND REQUIRING FURTHER FILINGS (May , 2001).

⁸ In the Matter of a School District Extended Area Service Petition Among the Exchanges of Dawson, Cerro Gordo, and Boyd, Docket No. P-405, 407, 522/CP-98-1642, ORDER SETTING EAS RATE ADDITIVES AND REQUIRING POLLING (May 25, 2001); In the Matter of a School District Extended Area Service Petition Among the Exchanges of Middle River, Greenbush, Strathcona, and Gatzke, Docket No. P-409, 432/CP-97-1756, ORDER SETTING EAS RATE ADDITIVES AND REQUIRING POLLING (May 25, 2001).

⁹ In the Matter of a Commission Investigation of Intrastate Access Charge Reform, Docket No. P-999/CI-98-674.

¹⁰ In the Matter of the Promulgation of Rules Governing the Competitive Provision of Local Telephone Service, Including Issues Related to Universal Service, Docket No. P-999/R-97-609.

B. Integrating Existing EAS Routes with New School District Route

While the Department is correct in noting that the cost studies on which the Companies based their proposed rates should have included all costs of the proposed route, including the cost of any existing EAS facilities that would service the new route, the Commission is unwilling to penalize the Companies for this omission. The statute explicitly requires that EAS rates include the “net book value of existing facilities transferred from another service to extended area service.”¹¹ The Companies are entitled to recover these costs through the EAS rate additives for the proposed route.

The Commission is unable to set new rates including these costs, however, because the record is incomplete on this issue. The Commission will therefore direct the Companies to file new cost studies which include the net book value of any existing facilities that will be used to provide the proposed EAS service and to file new EAS rate additives including these costs.

C. Implementation Issues

The School District EAS statute requires that all exchanges in a School District EAS route share the costs of the route equally:

The costs of providing extended area service under this section must be apportioned equally among the exchanges identified in the petition. The costs must be apportioned among the customers in each exchange so that the relationship between the rates for classes of basic local service remains the same.

...

Laws 1997, c. 59, subd. 6.

The Commission has long interpreted this requirement to mean that all subscribers who benefit from the route should bear equal responsibility for the costs and lost revenues associated with it, subject to preserving pre-existing ratios between customer classes (e.g., business, residential, pay phone). The Commission therefore sets School District rates by determining the total costs and lost access revenues for all companies combined and apportioning that revenue requirement between the exchanges according to the number of access lines in each exchange. The practical device for equalizing costs is “transfer payments” between the companies.

Although the Commission has eliminated transfer payments in recent conventional EAS cases, the Commission continues to use them in School District cases. The Legislature has placed a high value on toll-free calling within school districts and on spreading the financial responsibility for that toll-free calling equally among School District subscribers – the Commission will not dilute the impact of that policy judgment to promote competing policy goals.

¹¹ Laws 1997, c. 59, subd. 5.

The Commission will therefore follow standard School District EAS ratemaking procedures, combining all EAS-related costs and the lost access revenues of all four companies and apportioning the total between the exchanges on the basis of the weighted number of access lines in each exchange. Individual rates are then set by establishing equal residential rates and setting rates for other classes of service to preserve pre-existing ratios between customer classes.

The Companies will be required to file new cost studies and proposed rates reflecting these principles.

Finally, the Commission will require the companies to separately itemize on customers' bills and on the EAS ballot the portion of the EAS rate additive that recovers facilities costs and the portion that recovers lost access revenues. This information may be helpful in developing and implementing a universal service funding mechanism, which will replace, with explicit subsidies, subsidies that are now implicit.

The Commission will so order.

ORDER

- 1. Within 21 days of the date of this Order, Ace Telephone Association, Citizens Telecommunications of Minnesota, Harmony Telephone Company, and CenturyTel of Minnesota, Inc. shall file new cost studies including the net book value of any existing facilities that will be used to provide the School District EAS service at issue.**
- 2. Reply comments on the filings required in paragraph 1 shall be filed within 21 days of the date they are filed.**
- 3. Within 21 days of the date of this Order, Ace Telephone Association, Citizens Telecommunications of Minnesota, Harmony Telephone Company, and CenturyTel of Minnesota, Inc. shall file new EAS rate additives based on the cost studies required above. These rate additives shall include lost access revenues and shall reflect the per-exchange allocation methodology set forth by the Department of Commerce.**
- 4. Reply comments on the filings required in paragraph 3 shall be filed within 21 days of the date they are filed.**
- 5. The EAS rate additives adopted in this case shall be itemized, in polling materials and on subscribers' bills, to show which portion of the additive will recover facilities costs and which portion of the additive will recover lost access revenues.**

6. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

**Burl W. Haar
Executive Secretary**

(S E A L)

This document can be made available in alternative formats (i.e., large print or audio tape) by calling (651) 297-4596 (voice), (651) 297-1200 (TTY), or 1-800-627-3529 (TTY relay service).